

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

DOS BEACHES, LLC and MELINDA M.
RAYTER,

vs.

Plaintiff,

MAIL BOXES ETC., INC. and UNITED
PARCEL SERVICE, INC.,

Defendant.

CASE NO. 09CV2401-LAB (RBB)

**ORDER ON DEFENDANT'S
MOTION TO DISMISS**

Dos Beaches has filed an amended complaint containing a single claim alleging that Mail Boxes Etc., franchisor of a UPS Store operated by Dos Beaches, breached the covenant of good faith and fair dealing in their contractual relationship. Now pending is MBE's motion to dismiss.

I. Legal Standards

The relevant law hasn't changed since the Court last dismissed Dos Beaches' complaint. The Court will restate it here.

A. Motion to Dismiss

A 12(b)(6) motion to dismiss for failure to state a claim challenges the legal sufficiency of a complaint. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). In considering such a motion, the Court accepts all allegations of material fact as true and construes them in the

1 light most favorable to Dos Beaches. *Cedars-Sinai Med. Ctr. v. Nat'l League of Postmasters*
 2 of U.S.

3 , 497 F.3d 972, 975 (9th Cir. 2007). To defeat a 12(b)(6) motion, a complaint's factual
 4 allegations needn't be detailed; they must simply be sufficient to "raise a right to relief above
 5 the speculative level . . ." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). However,
 6 "some threshold of plausibility must be crossed at the outset" before a case can go forward.
 7 *Id.* at 558 (internal quotations omitted). A claim has "facial plausibility when the plaintiff
 8 pleads factual content that allows the court to draw the reasonable inference that the
 9 defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).
 10 "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than
 11 a sheer possibility that a defendant has acted unlawfully." *Id.*

12 While the Court must draw all reasonable inferences in Dos Beaches' favor, it need
 13 not "necessarily assume the truth of legal conclusions merely because they are cast in the
 14 form of factual allegations." *Warren v. Fox Family Worldwide, Inc.*, 328 F.3d 1136, 1139 (9th
 15 Cir. 2003) (internal quotations omitted). In fact, the Court does not need to accept any legal
 16 conclusions as true. *Iqbal*, 129 S.Ct. at 1949. A complaint does not suffice "if it tenders
 17 naked assertions devoid of further factual enhancement." *Id.* (internal quotations omitted).
 18 Nor does it suffice if it contains a merely formulaic recitation of the elements of a cause of
 19 action. *Bell Atl. Corp.*, 550 U.S. at 555.

20 **B. Covenant of Good Faith and Fair Dealing**

21 The covenant of good faith and fair dealing, "implied by law in every contract, exists
 22 merely to prevent one contracting party from unfairly frustrating the other party's right to
 23 receive the benefits of the agreement actually made." *Guz v. Bechtel Nat. Inc.*, 24 Cal.4th
 24 317, 349 (2000). The covenant finds particular application—although it is not limited
 25 to—"situations where one party is invested with a discretionary power affecting the rights of
 26 another. Such power must be exercised in good faith." *Carma Developers, Inc. v. Marathon*
 27 *Development California, Inc.*, 2 Cal.4th 342, 372 (1992); see also *Locke v. Warner Bros.,*
 28 *Inc.*, 57 Cal.App.4th 354, 363 (Cal. Ct. App. 1997). There are two important points to be
 29 made about the scope of the covenant.

1 First, there's no prerequisite that the underlying contract be breached in order for the
 2 covenant of good faith and fair dealing to be breached. "Were it otherwise, the covenant
 3 would have no practical meaning, for any breach thereof would necessarily involve breach
 4 of some other term of the contract." *Carma*, 2 Cal.4th at 373.

5 Second, the covenant of good faith and fair dealing is still tethered to the underlying
 6 contract, and cannot impose duties that aren't contemplated by it. "It is universally
 7 recognized the scope of conduct prohibited by the covenant of good faith is circumscribed
 8 by the purposes and express terms of the contract." *Id.* The covenant "cannot impose
 9 substantive duties or limits on the contracting parties beyond those incorporated in the
 10 specific terms of their agreement." *Guz*, 24 Cal.4th at 349. See also *Carma*, 2 Cal.4th at
 11 374 ("We are aware of no reported case in which a court has held the covenant of good faith
 12 may be read to prohibit a party from doing that which is expressly permitted by agreement.
 13 On the contrary, as a general matter, implied terms should never be read to vary express
 14 terms."); *Los Angeles Equestrian Ctr., Inc. v. City of Los Angeles*, 17 Cal.App.4th 432, 447
 15 (Cal. Ct. App. 1993) ("If there exists a contractual relationship between the parties . . . the
 16 implied covenant is limited to assuring compliance with the express terms of the contract,
 17 and cannot be extended to create obligations not contemplated in the contract.").

18 The covenant, in other words, "is designed to effectuate the intentions and reasonable
 19 expectations of parties reflected by mutual promises within the contract." *Nein v. HostPro,*
 20 *Inc.*, 174 Cal.App.4th 833, 852 (Cal. Ct. App. 2009). It's not limited to the express duties in
 21 the contract, but it's not the functional equivalent of an addendum or rider to the contract,
 22 either.

23 **II. Discussion**

24 Dos Beaches points to seven things MBE allegedly did in breach of the covenant of
 25 good faith and fair dealing. Any one, individually, could give rise to a claim, and so the Court
 26 will address them individually.

27 **A. Location of Dos Beaches' Franchise**

28 The first grievance of Dos Beaches giving rise to its claim is that MBE determined the

1 location of Dos Beaches' UPS Store Franchise and misrepresented how profitable the
 2 franchise would be in that location. (SAC ¶¶ 15–17.)

3 This can't be right. The Franchise Agreement is clear that the *franchisee* first selects
 4 a location, for MBE to accept before the Franchise Agreement is even official. Moreover,
 5 the franchisee makes its selection on the understanding that it is ultimately responsible for
 6 it and cannot later attempt to hold MBE liable for any assistance it may have offered.

7 You understand that while MBE or its Area Franchisee may
 8 assist you in selecting a site for your Center and provide input
 9 regarding the terms and conditions of the lease and may assist
 10 in negotiating the lease, the ultimate decision and final
 11 responsibility on whether to accept the site and the lease is
 12 yours. You hereby release and hold MBE and its Area
 13 Franchisee harmless from any liability resulting from their efforts
 14 to assist you in selecting a site or negotiating a lease You
 15 also understand that there is a risk that the site you select or the
 16 lease you sign may not meet all of your expectations or desires.
 17

(Offering Circular ¶ 3.) Dos Beaches signed the Franchise Agreement first, on September
 13 7, 2004. And *Dos Beaches*, not MBE, named the location of its franchise: 341 East 81st
 14 Street in Merrillville, Indiana. It wasn't until MBE later signed the Franchise Agreement, on
 15 September 29, 2004, that it accepted the East 81st Street location and the Franchise
 16 Agreement became a binding contract. The Franchise Agreement is clear on this:
 17

18 The location of Franchisee's Center, set forth on page one of
 19 this Agreement, has been accepted by MBE. Nevertheless,
 20 MBE's acceptance of the location set forth above as the
 21 Location shall in no way constitute a representation nor an
 22 express or implied warranty as to the viability or success of a
 23 Center at such location. Upon MBE's acceptance of such
 24 proposed location, such location shall be deemed to be the
 25 "Location", as defined herein below.

26 (Franchise Agreement at 6.) If Dos Beaches believed it hadn't been given a meaningful
 27 opportunity to scout out its own franchise location, and that MBE forced the location on it,
 28 the solution was simple: Dos Beaches should have never signed the Franchise Agreement
 on September 7, 2004 and presented it to MBE for acceptance.

26 There are at least two reasons, then, why Dos Beaches can't state a claim here for
 27 breach of the covenant of good faith and fair dealing. First, there wasn't a live contract
 28 between the parties when the franchise location was chosen such that the covenant of good

1 faith and fair dealing even existed. And second, given that the Franchise Agreement clearly
 2 places the burden on the franchisee to select a location *and* releases MBE from any liability
 3 arising out of this selection, Dos Beaches' claim would plainly violate the principle that the
 4 covenant "cannot impose substantive duties or limits on the contracting parties beyond those
 5 incorporated in the specific terms of their agreement." *Guz*, 24 Cal.4th at 349. Indeed,
 6 letting Dos Beaches' claim go forward would effectively write those express terms out of the
 7 Franchise Agreement.

8 **B. Display of the UPS Logo**

9 The Franchise Agreement gives Dos Beaches the right to use and display the UPS
 10 logo. (Franchise Agreement at 2.) There's no dispute about that. Dos Beaches alleges,
 11 however, that MBE breached the covenant of good faith and fair dealing by: (1) insisting on
 12 negotiating a commercial lease on Dos Beaches' behalf; and (2) negotiating a lease that
 13 precluded Dos Beaches from displaying the UPS logo. (SAC ¶¶ 18–23.)

14 Dos Beaches runs into the same problem here as it does above. The Franchise
 15 Agreement expressly places the ultimate responsibility for accepting a lease on Dos
 16 Beaches, and it releases MBE from any liability resulting from its own efforts to assist in
 17 negotiating a lease. (Offering Circular ¶ 3.) Allowing Dos Beaches to sue MBE for
 18 negotiating an inadequate lease would, again, essentially write these terms out of the
 19 Franchise Agreement, and the covenant of good faith and fair dealing isn't that powerful.
 20 Moreover, the lease between Dos Beaches and its landlord was entered into on September
 21 7, 2004, before the Franchise Agreement was accepted by MBE—that is, before the
 22 Franchise Agreement became a binding contract and the covenant of good faith and fair
 23 dealing came into play. (Franchise Agreement at Ex. I-1.) If Dos Beaches was
 24 uncomfortable with its lease, it either shouldn't have signed it or the Franchise Agreement.

25 **C. Interference with Lease Modification**

26 According to Dos Beaches, when its UPS Store was underperforming it entered into
 27 talks with its landlord to both lower the rent and modify the lease to allow it to display the
 28 UPS logo—and MBE interfered. Dos Beaches alleges that MBE both "eliminat[ed] the

1 reduction of rent" (which seems like something only the landlord could do) and eliminated
 2 any incentive for the landlord to work with Dos Beaches by saying a competitor, Max
 3 Molinaro, would be taking over the space. (SAC ¶ 25.)

4 MBE tries to eliminate this claim by arguing that Dos Beaches "does not refer to any
 5 express benefit conferred it under the Franchise Agreement that MBE unfairly interfered
 6 with." (Dkt. No. 38 at 10.) Obviously, MBE is seizing here on the principle that a claim for
 7 breach of the covenant of good faith and fair dealing "is limited to assuring compliance with
 8 the express terms of the contract . . ." *Angeles Equestrian Ctr.*, 17 Cal.App.4th at 447. But
 9 there is a relevant express term here. As noted, the Franchise Agreement places the
 10 responsibility for negotiating a lease on Dos Beaches. It even advises Dos Beaches to retain
 11 an attorney or real estate broker to negotiate the lease. With this warning, Dos Beaches
 12 could have sensibly expected that MBE wouldn't intervene in its lease negotiations in a
 13 manner adverse to Dos Beaches' interests. By executing the Franchise Agreement, in other
 14 words, Dos Beaches bargained for the benefit, among other things, of negotiating its own
 15 lease, and the covenant of good faith and fair dealing exists precisely to "prevent one
 16 contracting party from unfairly frustrating the other party's right to receive the benefits of the
 17 agreement actually made." *Guz*, 24 Cal.4th at 349. To the extent Dos Beaches alleges that
 18 MBE interfered with this benefit, it has stated a claim for breach of the covenant of good faith
 19 and fair dealing. True, the Franchise Agreement releases MBE from any liability for its
 20 efforts in *assisting* in lease negotiations, but that doesn't mean it also releases MBE from
 21 liability for *impeding* lease negotiations.

22 D. Refusal to Provide Marketing Materials

23 Dos Beaches alleges that MBE promised it marketing materials before it signed the
 24 Franchise Agreement, but that MBE subsequently "did not supply Plaintiff with marketing
 25 materials of the same quantity and quality as the marketing materials that it provided to other
 26 franchisees." (SAC ¶ 30.)

27 There's an obvious problem with trying to state a claim here for breach of the
 28 covenant of good faith and fair dealing. *Nowhere* in the Franchise Agreement are

1 promotional materials mentioned. Indeed, Dos Beaches only alleges that they were
 2 promised before the Franchise Agreement was executed, presumably as an enticement.
 3 The covenant, however, can't impose duties or obligations "beyond those incorporated in the
 4 specific terms of the[] agreement." *Guz*, 24 Cal.4th at 349. It is strictly intended to satisfy
 5 the "reasonable expectations of parties reflected by mutual promises *within the contract*."
 6 *Nein*, 174 Cal.App.4th at 852 (emphasis added). The promise of promotional materials,
 7 however, is completely extraneous to the Franchise Agreement, and again, holding MBE to
 8 such a promise would either re-write the Franchise Agreement or impose a supplemental
 9 agreement altogether. That's not the purpose of the covenant of good faith and fair dealing.

10 **E. Refusal to Grant Request to Relocate**

11 Frustrated with the success of its UPS Store at its initial location, Dos Beaches began
 12 to try to grow its customer base in another area with the goal of relocating to that area. MBE
 13 refused to grant Dos Beaches permission to move, however, and Dos Beaches claims this
 14 was a breach of the covenant of good faith and fair dealing. (SAC ¶¶ 32–34.)

15 The Court previously suggested that this particular claim might be plausible because
 16 it at least has some grounding in the Franchise Agreement. Specifically, the Franchise
 17 Agreement allows the franchisee to relocate with MBE's written consent:

18 Franchisee may relocate Franchisee's Center (even within the
 19 Territory) only with MBE's prior written consent, and upon such
 20 terms and conditions as MBE may prescribe in the Manuals,
 21 which may include: (I) modification of the boundaries of the
 Territory; and (ii) upgrading, renovating or remodeling the
 proposed new location to the then-current design, and other
 criteria or specifications indicated in the Manuals.

22 (Franchise Agreement at 2.) The implication of this is that if Dos Beaches' first location
 23 turned out to be a dud, MBE would be open to a relocation on certain terms. This was a
 24 reasonable expectation on Dos Beaches' part having executed the Franchise Agreement.
 25 To be sure, this isn't a promise that a relocation would be authorized no matter what, but the
 26 Court refused to rule out the possibility that the *unreasonable* refusal of a relocation request
 27 may constitute a breach of the covenant of good faith and fair dealing:

28 Consider the Relocation Claim, for example. Here, Rayter
 points to a particular contractual provision that allows for

1 relocation “only with MBE’s prior written consent, and upon such
 2 terms and conditions as MBE may prescribe in the Manuals . . .” If Rayter contends that Defendants were completely and
 3 deliberately unreasonable in considering her request for
 4 relocation, the Court can envision a credible argument that this
 “unfairly frustrat[ed] [Rayter’s] right to receive the benefits of the
 agreement actually made.” *Guz*, 24 Cal.4th at 349.

5 (Dkt. No. 35 at 20.) MBE now argues that the Court was wrong, and that MBE “did not agree
 6 that it would exercise its discretion to permit Dos Beaches to [relocate] either reasonably or
 7 in good faith.” (Dkt. No. 38 at 13.) Rather, “the Franchise Agreement gave MBE the right
 8 to refuse consent without limitation.” (*Id.*) MBE relies upon *Third Story Music, Inc. v. Waits*,
 9 41 Cal.App.4th 798 (Cal Ct. App. 1995).

10 In *Waits*, the court set out to resolve “an apparent inconsistency between the principle
 11 that the covenant of good faith should be applied to restrict exercise of a discretionary power
 12 and the principle that an implied covenant must never vary the express terms of the parties’
 13 agreement.” *Id.* at 804. Or, to put it another way, “When an agreement expressly gives to
 14 one party absolute discretion over whether or not to perform, when should the implied
 15 covenant of good faith and fair dealing be applied to limit its discretion?” *Id.* at 802. Here’s
 16 the answer: when the agreement would be illusory without the covenant.

17 The conclusion to be drawn is that courts are not at liberty to
 18 imply a covenant directly at odds with a contract’s express grant
 19 of discretionary power except in those relatively rare instances
 when reading the provision literally would, contrary to the parties’
 clear intention, result in an unenforceable, illusory agreement.

20 *Id.* at 808. The court went on to explain that an illusory promise in an agreement doesn’t
 21 make the agreement itself illusory, provided it is supported by consideration.

22 The TSM/Warner agreement states that Warner may market the
 23 Waits recordings, or “at its election” refrain from all marketing
 efforts. Read literally, as the trial court did and respondent
 24 would have us do, this is a textbook example of an illusory
 25 promise. At the same time, there can be no question that the
 26 parties intended to enter into an enforceable contract with
 binding promises on both sides. Were this the only
 consideration given by Warner, a promise to use good faith would necessarily be in

27 The illusory promise was not, however, the only consideration
 28 given by the licensee. . . . It follows that, whether or not an
 implied covenant is read into the agreement, the agreement
 would be supported by consideration and would be binding.

1 *Id.* at 808. *Waits* clearly cuts in MBE's favor. Even if there is an illusory quality to MBE's
 2 discretion to approve Dos Beaches' relocation, the Franchise Agreement isn't just a
 3 relocation agreement; there are plenty of other terms supported by ample consideration on
 4 both sides. That ends the argument here. Under *Waits*, the Court cannot imply a covenant
 5 of good faith and fair dealing with respect to the relocation clause of the Franchise
 6 Agreement.

7 **F. Divulging Confidential Information to a Competitor**

8 Dos Beaches claims that MBE passed its confidential research on an alternative
 9 location to a favored competitor-franchisee, who then opened a UPS Store at that location.
 10 According to Dos Beaches, "[t]his essentially took the time, money and work that Plaintiff had
 11 invested in a targeted market area and converted it for the benefit of a competing franchisee,
 12 inflicting financial harm on Plaintiff's business by eliminating its ability to earn a profit." (SAC
 13 ¶ 38.)

14 The Franchise Agreement explicitly states that Dos Beaches has the exclusive right
 15 to operate a UPS Store within a certain territory, but it also gives MBE more or less total
 16 freedom to franchise other UPS Stores outside of that territory—no matter how close they
 17 are to Dos Beaches' UPS Store and no matter if they take away customers from Dos
 18 Beaches.

19 Except as set forth in this Section 1.2, neither MBE or its
 20 Affiliates will own or operate a Center, as that term is specifically
 21 defined herein, nor license or franchise others to do so at any
 site located within the Territory.

22 MBE expressly reserves (for itself and for its Designees) the
 23 exclusive, unrestricted right to produce, franchise, license, sell,
 24 distribute and market any products or services (under any
 25 brands, including but not limited to the Marks) from any Retail
 26 Outlets (including, but not limited to, traditional Centers or Non-
 27 Traditional Sites) the physical premises of which are located
 28 outside of the Territory, regardless of (i) the proximity of such
 Retail Outlet to the Franchisee's Center at the Location, or (ii)
 whether or not such products or services are purchased by
 customers whose residences or places of business are located
 within the Territory.

(Franchise Agreement at 2.) So, simply allowing Molinaro to open a competing UPS Store
 outside of Dos Beaches' territory cannot give rise to a claim for breach of the covenant of

1 good faith and fair dealing. Can the disclosure of Dos Beaches market research to Molinaro
 2 state a claim, though? The Court doesn't believe so. First, it has already found that there's
 3 no language whatsoever in the Franchise Agreement pertaining to the disclosure of a
 4 franchisee's information, and returning to a recurring principle, the Court cannot create
 5 obligations under the covenant of good faith and fair dealing that aren't incorporated or
 6 contemplated in the Franchise Agreement's terms. Second, the purpose of the covenant is
 7 to "prevent one contracting party from unfairly frustrating the other party's right to receive the
 8 benefits of the agreement actually made," *Guz*, 24 Cal.4th at 349, and Dos Beaches can't
 9 argue that the disclosure of certain information to Molinaro frustrated its own right to operate
 10 a profitable UPS Store in its defined territory. The information was presumably useful only
 11 insofar as it helped Molinaro open a UPS Store outside of Dos Beaches' territory, and that
 12 is expressly allowed by the Franchise Agreement.

13 **G. Refusal to Grant Second Request to Relocate**

14 Dos Beaches' final basis for its claim that MBE breached the covenant of good faith
 15 and fair dealing is that a second request to relocate was unreasonably handled by MBE.
 16 This cannot be the basis of a claim for the same reason that the rejection of its first
 17 relocation request cannot be the basis of a claim: the Franchise Agreement gives MBE
 18 discretion to reject a relocation request, and the covenant of good faith and fair dealing can't
 19 govern the exercise of that discretion when, as a whole, the Franchise Agreement is
 20 supported by consideration on both sides.

21 **III. Conclusion**

22 MBE's motion to dismiss is **GRANTED IN PART AND DENIED IN PART**. Dos
 23 Beaches' claim for breach of the covenant of good faith and fair dealing survives on one,
 24 narrow basis: the Franchise Agreement gives Dos Beaches the responsibility and right to
 25 negotiate a lease, but in the end MBE inserted itself into Dos Beaches' lease renegotiations
 26 and thwarted Dos Beaches' objectives. The Court certainly understands Dos Beaches' other
 27 grievances, but for the reasons given they cannot be the basis of a claim that MBE breached
 28 the covenant.

1 The Court acknowledges that when it last ruled on MBE's motion to dismiss, it hinted
 2 that Dos Beaches may have a more substantial claim that it is allowing here. (See Dkt. No.
 3 35 at 20–21.) The explanation for this is simple: the complaint the Court was considering
 4 then simply wasn't clear *at all* as to what the specific bases of Dos Beaches' claim were, and
 5 the Court was forced to charitably speculate.

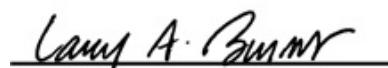
6 The Defendants and the Court still have no idea what specific
 7 conduct of the Defendants is behind Rayter's claim. Again, the
 8 claim itself just incorporates by reference every single grievance
 9 against the Defendants, accompanied by the statement that [the]
 10 implied covenant was breached The Court considered
 11 *thirteen* different acts of Defendants that, in Rayter's mind,
 12 apparently give rise to a breach of contract claim. It is
 13 completely unclear whether she believes that all of them, or
 14 some subset of them, also give rise to a claim for breach of the
 15 covenant of good faith and fair dealing

16 (Dkt. No. 35 at 19.) Now that Dos Beaches' Second Amended Complaint offers explicit and
 17 specific bases for its claim, it's clear that many of those bases fail. In fact, almost all of them
 18 do. They fail because they either: (1) involve conduct that pre-dates the execution of the
 19 Franchise Agreement; (2) would eviscerate particular discretions the Franchise Agreement
 20 gives to MBE; or (3) attempt to ladle onto the Franchise Agreement obligations on MBE's
 21 part that simply don't appear in, or aren't contemplated by, its express terms.

22 It is time for this case to go forward, even if it does so with hardly a pulse. It survives
 23 a motion to dismiss on the most narrow of bases: the Franchise Agreement gives Dos
 24 Beaches the responsibility for negotiating a lease, but when it attempted to do so MBE
 25 inserted itself unnecessarily and adversely.

26 **IT IS SO ORDERED.**

27 DATED: May 23, 2012

28 

HONORABLE LARRY ALAN BURNS
 United States District Judge